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Fundamental Issues for Reform of the Law of Contractual Interpretation

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Abstract

This article considers the issue of reform of the principles of interpretation of contract, particularly in the light of the recent Scottish Law Commission Discussion Paper on Contractual Interpretation (SLC DP No. 147).

Keywords

Contract, interpretation, construction, objectivity, subjectivity.

Fundamental Issues for Reform of the Law of Contractual Interpretation

Martin Hogg^{*}

A. INTRODUCTION

B. SUBJECTIVE OR OBJECTIVE UNDERSTANDINGS OF THE NATURE OF CONTRACT

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D. THE WAY FORWARD FOR LAW REFORM

A. INTRODUCTION

In every legal system there exist a number of perennially troubling aspects of contract law, among them the questions of whether a contract has in fact been formed, alleged errors in contracting, the extent of recoverable damages, and the proper interpretation (or "construction")¹ of the contract's terms. The last of these is the subject of a recent Scottish

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¹ McBryde argues (W W McBryde, *The Law of Contract in Scotland*, 3rd edn (2007) para 8-05) that interpretation and construction are two distinct tasks, but this may have been seen by the Law Commission either as an overly fussy distinction or else as a distinction without a difference, as no reference is made in the Discussion Paper to any apparent difference between the two concepts. For academic discussion of Scottish legal perspectives on interpretation of contract, see L Macgregor and C Lewis, "Interpretation of contract", in R Zimmermann, D Visser and K Reid (eds), *Mixed Legal Systems in Comparative Perspective: Property and Obligations in Comparative Perspective* (2004) 66, and D Cabrelli, "Interpretation of contracts, objectivity and the elision of consent reached through consent and compromise" 2011 JR, forthcoming.

Law Commission Discussion Paper,² this paper forming part of the Commission's ongoing review of contract law announced in its Eighth Programme of Law Reform.³

If one were to attempt to suggest anything linking these perennially troubling aspects of contract law, one strong candidate would present itself, that being the question of whether, at root, contracts are constituted by the subjective agreement of the parties or by the objective impression which the conduct of such parties presents. The tension between these two perspectives on contracts, the subjective and objective, lies at the very heart of the divergent will and reliance families of contract theory. A tendency to prefer one perspective over the other has had a profound impact upon the judicial assessment of whether parties have yet reached the point of a binding agreement at law, upon policies relating to error, upon the extent of damages recoverable on breach, and – the subject of the matter at hand – upon the approach of courts to the interpretation of contract terms.

B. SUBJECTIVE OR OBJECTIVE UNDERSTANDINGS OF THE NATURE OF CONTRACT

Historically, Scots contract law has been said to rest upon the agreement of the parties, an exercise which supposes the ascertainment of whether, subjectively, they have reached *consensus in idem*. In keeping with this, our law has preferred a will theory of contract, rejecting competing ideas that contractual liability is generally based upon reliance (even if reliance-based liability has grounded remedies for misrepresentation, undue influence, and the like).⁴ Yet, at least since the nineteenth century (but arguably even earlier, since Stair first stressed the necessity for “engagement” before obligations could be constituted),⁵ it has been recognised that, for all practicable purposes, it is the objective manifestation of the will of the parties upon which courts rely in determining contractual formation and content: not “what did they do?” but “what did they reasonably appear to do?”. Lord President Dunedin's famous words in *Muirhead & Turnbull v Dickson*⁶ are often cited to illustrate this, but there are numerous other dicta demonstrating this view. There remains a tension in the law as to whether the proper objective perspective ought to be entirely detached objectivity or rather

² Scottish Law Commission, Discussion Paper on *Interpretation of Contract* (Scot Law Com No 147, 2011).

³ Scottish Law Commission, *Eighth Programme of Law Reform* (Scot Law Com No 220, 2010).

⁴ On the place of the will and reliance theories in Scots law, see M Hogg, “Perspectives on contract theory from a mixed legal system” (2009) 29 OJLS 643.

⁵ Stair, *Inst* 1.10.2.

⁶ (1905) 7 F 686.

the objectivity of a reasonable person in the shoes of the contracting parties (what might be called “subjective objectivity”), and there are competing views of courts sometimes stressing one over the other, but the pendulum has undoubtedly swung, in general terms, away from the subjective to one or other manifestation of the objective.

How does the issue of objectivity versus subjectivity play out in the field of contractual interpretation? In a number of different ways. At heart, there is the fundamental question of whether contracting parties, in choosing to embody their contract in a particular language and in using particular words from that language, submit themselves to the idea that language has an objective meaning. The idea that it does is the very basis of dictionaries. Dr Johnson would not have got very far in his enterprise if there had been no generally agreed meanings to words.⁷ We do, of course, recognise generally agreed meanings for words, and, when we speak, we make use of such meanings, albeit that the same word can have a number of different meanings depending upon the context in which we use it, and that, while some meanings for words are dropping out of use, others are constantly arising. The law, through the faculty of our wills, allows us to bind ourselves to obligations. To paraphrase Aquinas,⁸ we make, as it were, a law to ourselves when we contract. What we are taken to mean in the contracts we conclude is thus immensely important.

On one view of our faculty to bind ourselves contractually, we may even be entitled to create our own personal language or dictionary, one constructed without regard to the meaning which the language we use ordinarily ascribes to the words used by us in the context in question. That, at least, is the conclusion reached from a strong emphasis upon the subjective will of the parties: if what is crucial, in assessing contracts, is discovering what parties really intended, then we should use all available evidence to uncover the meaning which those parties gave to the words and phrases they used. Such an approach gives rise to a very private view of contract: a contract is essentially a personal matter of the parties – if outsiders would be puzzled at what the parties meant when saying what they did, that is of no importance.

There is a different view of contracts, however. If parties choose to frame their agreement in a specific language, then it can be said that they submit to the fundamental purpose of language: communication through the use of a shared linguistic medium. Such a shared medium depends upon words having an objectively agreed meaning, albeit one which

⁷ Notwithstanding the comment of Humpty Dumpty in Lewis Carroll’s *Through the Looking Glass* that “When I use a word ... it means just what I choose it to mean – neither more nor less”.

⁸ See Aquinas, *Summa Theologica*, II-II, Q 88, art 10.

may be finely attuned to the specific context in which the words are used (that context being not merely one of sentence structure, but, especially in a legal context, one relating to the legal end which an agreement is designed to serve). Such a view overcomes the difficulty that each of the parties may have had a different understanding of the words being used (a problem which evidently cannot be solved on a subjective, agreement approach), as it holds that the parties must be taken to have intended the objective meaning of the words used in the relevant context. It also recognises that contracts have not just a private life, but also a public one: contracts may confer rights upon third parties, either under a *jus quaesitum tertio* or through assignation; contracts may be subjected to taxes dependent upon their content (as, for instance, in the case of stamp duty); contracts may be registered in public registers, and may require to be enforced by public officials, including the keepers of registers, arbiters, and courts. Very few contracts are entirely private affairs. An approach to the construction of contracts which emphasises the objective meaning of words seems most suited to the recognition of these public aspects of contracts.

The discussion up to this point may have seemed overly theoretical, but its significance lies in the fact that the theory adopted will heavily influence the detail of the rules chosen in any system for the construction of contracts. It is not surprising then to see that the theoretical questions discussed above have heavily influenced the debates about interpretation of contracts which have featured in the significant judicial decisions of the last fifteen years or so, as well as the content of the new Discussion Paper produced by the Law Commission. The theory preferred – whether it tends towards subjectivity or objectivity – influences a number of interpretative issues, among them the following: (1) a legal system's fundamental or basic rule of interpretation, (2) the question of the breadth of the context or conduct which can be referred to in the interpretative exercise, (3) whether consideration of anything beyond the words of the contract alone is only permissible in cases of "ambiguity"; (4) the position of third parties; (5) the use of maxims or rules of interpretation; and (6) the permissibility and function of so-called "entire contract clauses". The Discussion Paper considered all of these issues (making some suggestions for law reform on some of them) and sought the views of interested parties on them.

C. THE FUNDAMENTAL ISSUES RAISED IN THE DISCUSSION PAPER

The Commission was not beginning from a tabula rasa. In 1997 it issued a Report on Interpretation in Private Law (henceforth “RIPL”),⁹ but the recommendations contained in the report were never implemented. The matter of interpretation was thus, for the Commission, very much one of unfinished business. In addition to this previous Report, there has since 1997 been something of a revolution (led by Lord Hoffmann) in judicial thought on interpretation, though the radical manifesto of this revolution has not met with universal approval on the Scottish and English benches. New model law, principally the Principles of European Contract Law (PECL) and the Draft Common Frame of Reference (DCFR), has also addressed the question of contractual interpretation. There was thus much for the Commission to ponder in this new Discussion Paper. Its contribution can usefully be considered by reference to the seven interpretative issues listed above:

(1) The legal system’s fundamental or basic rule of interpretation

It is common for legal systems to have a basic rule embodying the approach to be taken by courts (and other arbiters) towards contract interpretation. Traditionally, British courts began by looking at the “natural meaning” of the words used in the contract,¹⁰ such natural meaning being (in the words of Lord Mustill in *Charter Reinsurance v Fagan*)¹¹ “their primary meaning in ordinary speech”.¹² Contracts may, of course, deal with technical matters, often in highly specialised contexts, so that the meaning to be given to a specific word or phrase may in the context have to give way to one which is not its primary meaning in ordinary speech. This indeed was the conclusion of the House of Lords in *Charter Reinsurance*, where the context of the words used – a specialised form of reinsurance – pointed to a meaning other than the primary meaning of the words in ordinary speech. The “natural meaning” approach emphasises the objective meaning of words over the parties’ subjective, and perhaps entirely private, understanding of the words used. This traditional approach is also – contrary to some popular belief – a contextual approach to interpreting language: as a glance through any good

⁹ Scottish Law Commission, *Report on Interpretation in Private Law* (Scot Law Com No 160, 1997).

¹⁰ It should be emphasised that the “natural meaning” of a word or phrase will not always be its “literal meaning”, although the ideas of the natural and literal meaning have sometimes been conflated by those commenting on contractual interpretation. Thus, the phrase “it’s raining cats and dogs” has a literal meaning which is evidently not the primary meaning of the phrase in ordinary speech (that primary meaning signifying that it is raining heavily). This point is worth stressing, as sometimes it is stated that the usual rule of contractual interpretation is the literal rule when what is more properly meant is the “natural” or “ordinary” rule of interpretation.

¹¹ [1997] AC 313.

¹² [1997] AC 313 at 384.

dictionary will show, most words have a number of meanings objectively ascribed to them, the difference in such meanings depending upon the context in which the words are used.

Beginning in 1997, Lord Hoffmann pioneered a new approach to interpretation, one which places much greater stress upon the subjective meaning ascribed by parties to the words used by them. Lord Hoffmann had hinted at his dissatisfaction with the traditional approach when he doubted the coherence of a “natural meaning” view of language in *Charter Reinsurance*.¹³ His full view was made plain in his important speech in *Investors’ Compensation Scheme v West Bromwich Building Society*.¹⁴ While some of what he said did no more than repeat elements of the traditional approach, in saying that, in every question of contract interpretation, the crucial question to be answered was the meaning “the document would convey to a reasonable person having all the background knowledge which would reasonably have been available to the parties in the situation in which they were in at the time of the contract”, he shifted the emphasis of the interpretative investigation towards the subjective intention of the parties. Although he made use of the idea of the “reasonable person” in the parties’ shoes (a nod to the idea of “subjective objectivity” discussed earlier), by including “all the background knowledge” of the parties the subjective element of this apparently objective exercise is allowed to dominate to an extent that may lead a court wholly back to the subjective intention of the parties in certain cases.

As for model law published since 1997, the DCFR adopts something of a Hoffmann line: article II.-8:101 states that “[a] contract is to be interpreted according to the common intention of the parties even if this differs from the literal meaning of the words”.¹⁵ This contrasts with the Law Commission’s previous approach in the RIPL, where the suggestion was made that the fundamental rule should be that “[a]ny expression which forms part of a juridical act shall have the meaning which would reasonably be given to it in its context”.¹⁶ This is much more redolent of an objective approach to interpretation, there being no mention of the common intention of the parties. In the new Discussion Paper, however, the Commission states that it is no longer content with its former approach. It suggests amending that former approach to include reference to the “common intention” of the parties, without

¹³ [1997] AC 313 at 391.

¹⁴ [1998] 1 WLR 896.

¹⁵ Note that the intention of the parties is contrasted with the literal meaning of the words, rather than the natural meaning: see n 10 above, on why suggestions that courts were traditionally bound slavishly to the literal meaning is incorrect. In suggesting that the literal meaning is the counterfoil to the common intention of the parties, the DCFR somewhat caricatures the traditional approach, at least so far as it has operated in Scotland and England.

¹⁶ Para 1(1) of the Schedule to the draft Bill proposed in the RIPL.

however going quite as far as Lord Hoffmann towards subjectivity. In so doing the Commission appears to be attempting to marry the twin concerns of subjectivity and objectivity in a compromise policy:¹⁷

<EXT>the fundamental aim of contract law in general, and of the law of interpretation in particular, is to give effect to the common intention of the parties, as suggested in the DCFR, but ... the basically objective approach of current Scots law and RIPL in determining that common intention is to be preferred to any more subjective one, and should be the basis for any reform proposals.<EXT>

Though the Discussion Paper does not provide the specific wording of any legislative provision which might embody such a compromise policy, it seems that the Scottish Law Commission envisage that such a provision might look something like the following:¹⁸

<EXT>The meaning of an expression in any contract is that which would reasonably be given to it in its context, taking account of

- (a) the parties' common intention,
- (b) the surrounding circumstances, and
- (c) the nature and purpose of the agreement,

each of which shall be determined objectively.<EXT>

The idea that the reasonable meaning to be ascribed to a word in its context (traditionally, in written contracts, confined to the express words used by the parties in the contractual documents)¹⁹ is to be determined with regard to the “common intention of the parties”, as well as the other two matters referred to, gives rise to an interesting question of just how far the common intention of the parties, not disclosed in the express words of the contract itself, might justify meanings which bear no relation to the natural (or indeed specialist) meaning of the words used in the linguistic context of the relevant documents. Would the Commission's

¹⁷ Para 6.28.

¹⁸ The suggested wording given does not appear in the Discussion Paper, but is made here on the basis of the statement in the paper that “[w]e would favour a formulation along the broad lines of paragraph 1(1) of the Schedule to the draft Bill annexed to RIPL, but including a reference to the common intention of the parties, objectively ascertained” (para 7.6) as well as Question 4 posed in the paper (see para 7.9).

¹⁹ Though, since the implementation of section 1 of the Contract (Scotland) Act 1997, no longer confined to the document(s) apparently comprising the contract.

suggested approach require a court to enforce an entirely private meaning given by the parties to a contract word or phrase, even one which might seem absurd to a reasonable objective observer?²⁰ Would, for instance, A and B, writing “hectare” in their contract but, through their shared misunderstanding as to the meaning of the word hectare, in reality intending “acre”, be entitled to a judicial determination that the wording in the contract should mean “acre”?²¹ The answer seems not entirely clear from the Discussion Paper, but, if it is in the affirmative, then while such a result might agree with decisions permitting the use by parties of a “private dictionary”,²² such an approach could rightly be described as paying only lip service to the idea of objectivity. Hard cases such as this demonstrate the difficulty of trying to marry objectivity and subjectivity in some compromise which appears to give preference to neither.

Though the proposed approach in the Discussion Paper could easily deal with cases (of which there are many instances) where no common intention of the parties is discernible²³ – in such a case, the factor of common intention would simply be omitted from the interpretative exercise – in hard cases common intention may be pitted against objective appearance. It is suggested that, to deal with such hard cases, any legislation addressing a fundamental default rule for interpretation must disclose a preference. Both the DCFR and RIPL suggest a (different) preference: there will doubtless be differing views as to which is preferable. However, a compromise of the type which appears, on this reader’s understanding, to have been suggested by the Commission will not produce a clear cut answer in difficult cases.

The Commission’s view may be that, because the context must “take account” of the parties’ intentions, this inevitably subjugates the language apparently used to the subjective intention of the parties, but if that is the case it would surely be better to state explicitly (as

²⁰ McBryde has argued strongly, by reference to authority, that objectively absurd meanings will not be supported by the courts: McBryde, *Contract* (n 1) paras 8.13-8.16.

²¹ Yes, if the parties’ common intention is to trump other factors; however, an absurd meaning is one which it would be hard to justify as being “reasonably given”, as the Commission’s proposed test requires. The parties in this example would certainly be entitled to have the contract rectified under section 6 of the Law Reform (Miscellaneous Provisions) (Scotland) Act 1985, but to reach the same practical result using interpretative means seems to render the statutory remedy of rectification obsolete in such a case.

²² Discussed by Lord Hoffmann at para 45 of his speech in *Chartbrook v Persimmon* [2009] UKHL 38, [2009] 1 AC 1101. Modern judicial discussion of the ‘private dictionary’ principle derives from *Partenreederei MS Karen Oltmann v Scarsdale Shipping Co Ltd (The Karen Oltmann)* [1976] 2 Lloyd’s Rep 708, though elements of the idea may be traced back to the nineteenth century (see especially *Shore v Wilson, Lady Hewley’s Charities* (1842) 9 Cl & F 355).

²³ Either because the parties held private views about a matter which are at odds, or because they did not turn their minds to the issue when the contracts terms were concluded. Among recent cases where there appears to have been no common intention of the parties as to the matter in question are the *Investors’ Compensation Society* and *Chartbrook* decisions.

the DCFR does) a preference for common intention, at least where such a common intention exists.

(2) The question of the breadth of the context or conduct which can be referred to in the interpretative exercise

This second question is intimately related to the fundamental rule just discussed. A preference for a wide context (or “matrix of fact”, as it is often referred to) which can be considered in interpretative examinations will tend towards a subjective, party-intention approach to interpretation; a narrower context, consisting in many cases of the document(s) alone, will tend to an objective approach. Lord Hoffmann’s suggestion that “absolutely anything”²⁴ might be considered in all cases (a suggestion later modified, in the face of criticism, to “anything which a reasonable man would regard as relevant”)²⁵ creates a strong bias towards subjectivity. Curiously, however, Lord Hoffmann did not include within his “absolutely anything of relevance” approach either the pre-contractual negotiations of the parties or their conduct after the conclusion of the contract. Excluding these two matters has been a traditional peculiarity of British law: civilian systems, and even other Common law jurisdictions, allow recourse to such material, as the Discussion Paper narrates.²⁶

It is something of a puzzle why Lord Hoffmann, keen to promote as much of a focus on the parties’ common intention as possible, did not extend his revolutionary approach to revisiting the view that such pre- and post-contractual conduct cannot be considered by a court when assessing such intention. The typical justification for excluding pre-contractual conduct, that parties’ intentions may be modified between the time of their pre-contractual negotiations and that of contracting, is surely a matter of fact upon which courts can make a determination, as is the question of whether post-contractual conduct sheds any light on the common intention of the parties as to the meaning of the conduct. The SLC recommend allowing recourse to such conduct.²⁷ Given their suggestion that the common intention of the parties should feature in the fundamental rule of interpretation, this seems entirely logical. They also suggest that unilateral declarations of intent as to the meaning of contract terms

²⁴ [1998] 1 WLR 896 at 913A.

²⁵ *BCCI v Ali* [2001] UKHL 8, [2002] 1 AC 251 at para 39 per Lord Hoffmann.

²⁶ “[I]n other parts of the common law world reference to such material has either long been permissible as part of a generally contextual approach to interpretation (the USA) or is in the process of becoming so (New Zealand, Canada).”: Discussion Paper on *Interpretation of Contract* (n 2) para 4.25.

²⁷ Paras 6.19-6.23.

should be excluded from consideration,²⁸ which is again consistent with a stress upon the common intention of the parties.

(3) Whether consideration of anything beyond the words of the contract alone is only permissible in cases of “ambiguity”

Expressions of Scottish judicial views on this question since 1997 have tended to be against the Hoffmann position (Lord Hoffmann having strongly espoused the view that ambiguity is not required).²⁹ In *Forbo-Nairn v Murrayfield*,³⁰ Lord Carloway expressed the opinion that the traditional canons of interpretation (such as the *contra proferentem* and *ejusdem generis* rules) should only be brought into play once an ambiguity has been identified;³¹ in *Multi-Link Leisure Ltd v North Lanarkshire Council*,³² Lord Hope took a similar view when he commented that an interpretative exercise which essentially “re-words” the contract should not occur “until it has become clear that the language the parties actually used creates an ambiguity which cannot be solved otherwise”.³³

The Scottish Law Commission disapprove of this view, arguing that the idea of ambiguity is itself ambiguous, and that the genuine issue – uncertainty of meaning, rather than technical ambiguity – may not become obvious until surrounding circumstances are considered.³⁴ This seems a fair point, but also essentially a derivative one: if point (2) above is settled in favour of considering a wide context beyond the mere terms of the contract, it seems logical not to insist on a formalistic ambiguity requirement. That said, courts must always guard against the danger of meddling in contracts in which there is neither technical ambiguity nor uncertainty of meaning merely because they think the contract does not reflect a sensible arrangement: the impropriety of so doing is argued for below in relation to the ongoing litigation in *Aberdeen City Council v Stuart Milne Group*.³⁵

(4) The position of third parties

This issue brings us back to the question of whether contracts are properly to be seen as entirely private affairs or whether they have a wider, public aspect to them. Any such “public

²⁸ Para 7.10.

²⁹ Though for an instance of agreement with the Hoffmann view, see Lord Phillip’s comments in *City Wall Properties (Scotland) Ltd v Pearl Assurance plc* (No. 2) [2007] CSIH 79 at para 24.

³⁰ [2009] CSIH 94.

³¹ Para 12.

³² [2010] UKSC 47.

³³ Para 11.

³⁴ Discussion Paper on *Interpretation of Contract* (n 2) para 7.8.

³⁵ [2009] CSOH 80; [2010] CSIH 81.

aspect” could be said to encompass both persons apart from the original contracting parties who may derive rights under the contract, as well as persons who may be required to act upon or enforce the contract. As to the former, Scots law has always been more disposed towards the rights of third parties than has English law, given its less strict view of privity and its consequent historic willingness to allow the fairly free assignation of contracts and the creation of directly enforceable third party rights. The acknowledgement of the rights of such third parties can create problems for interpretation, however: a strongly subjective approach to interpretation, which would allow the parties to fashion the content of their contracts according to their own, perhaps private, intentions as to the meaning of words, runs the risk that third parties may be adversely affected through ignorance of such intentions.

How is a third party – perhaps a *tertius* under a *jus quaesitum tertio*, a lender making a decision on whether to lend on the faith of the contract, or a cautioner advancing sums based upon its reasonable interpretation of the contract – to know that a private, perhaps objectively obscure or absurd, meaning was ascribed by the parties to a contract term? One can take a strict line and say that such a party simply bears any risk of such ignorance. The Discussion Paper takes a softer, more charitable line, however, and one which makes a concession to objective, non-party based interpretation in a limited class of case: where a third party (excluding an assignee)³⁶ has reasonably relied upon the apparent meaning³⁷ of a written contract, the proposal is that a court should not make use of extrinsic evidence to determine the meaning of the contract in a question with that third party.³⁸ This would certainly protect the *tertius*, lender, or cautioner from being subjected to private meanings not evident to an objective observer of the contract terms, though it has the potential to create the somewhat complex result that the contract is taken to mean one thing for A and B but something different for C.

This concession does not, however, extend to the other class of party forming part of the public sphere of a contract, the third party who, while deriving no right from the contract, is required to act upon it in some way. What, for instance, of the Keeper of the Land Register who is faced with a disposition (the ambit of the Discussion Paper extends not just to the

³⁶ The rationale for the proposed exclusion of an assignee is that such a party stands in the shoes of its assignor, and so must be treated as if the original contracting party.

³⁷ The notion of “apparent meaning” is not spelt out in the Discussion Paper, but it may perhaps reasonably be assumed that it suggests the “ordinary meaning” of the words or phrase in question.

³⁸ Discussion Paper on *Interpretation of Contract* (n 2) paras 7.30-7.35 (the Commission sought views on whether assignees should also benefit from such a rule).

interpretation of contracts but to unilateral juridical acts also)³⁹ which purports not just to convey the ownership of land but also to grant certain rights of access, but somewhat vaguely described rights not specifically described as servitudes: could the Keeper refuse to list any servitudes on the title sheet for the subjects, even if the parties resolutely maintain that what they intended in the description of the rights in question was to create such servitudes? The Discussion Paper does not propose any special treatment for a party such as the Keeper of a public register similar to that applying in the case of a *tertius*, lender or cautioner, as such a party does not in any sense “rely” upon the *ex facie* meaning of the document in question. The result is that such a party (who is, in effect, treated as any other “interpreter” of the contract, such as a court) would seem to be governed by the proposed basic rule of interpretation, which, as discussed earlier, requires account to be taken of a wide context including the subjective intention of the relevant parties (or party).

(5) The use of maxims or rules of interpretation

The utility of traditional rules or maxims was dismissed by Lord Hoffmann in the *Investors’ Compensation Scheme* case when he said (in distinctly precipitous fashion) that “almost all the old intellectual baggage of ‘legal’ interpretation has been discarded”.⁴⁰ This was consistent with his Lordship’s view that interpreting contracts boils down to an examination of what, in fact, the parties actually meant by the words they used. RIPL did not propose specifically enacting any of these rules or maxims; some of them are however comprised in the provisions of the DCFR.⁴¹ No concluded view on this issue was taken in the Discussion Paper (though it was noted that the Economic Impact Group on the DCFR took the view that the rules are both favoured by commercial parties and reduce transaction costs),⁴² the Commission seeking the opinion of interested parties. Incorporating such rules, perhaps as last resorts to be adopted in some cases, clearly makes most sense on the basis of a predominantly objective approach to contractual interpretation (the rules purporting to embody objective features of language); on a subjective approach however, the rules have no obvious connection to the common intention of the parties and ought probably to be omitted, though they might still conceivably be used as solutions of last resort where no other obvious solution is evident. Given the apparent compromise embodied in the Commission’s

³⁹ “The general rule of interpretation (that any statement is to be given the meaning reasonably to be given to it in its context having regard to the surrounding circumstances and the nature and purpose of the juridical act) should be applied *mutatis mutandis* to unilateral juridical acts.” (para 7.41)

⁴⁰ [1998] 1 WLR 896 at 912G.

⁴¹ DCFR arts. II.-8:103-107.

⁴² Discussion Paper on *Interpretation of Contract* (n 2) para 7.38.

fundamental rule of interpretation, it is somewhat difficult to determine an obviously correct answer to the question posed by the Commission as to whether to include such rules or not.

(6) The permissibility and function of so-called “entire contract clauses”

The Discussion Paper narrates the concerns that some parties may have at the wide “matrix of fact” approach promoted by Lord Hoffmann and embodied in the paper’s suggested general rule.⁴³ The Commission therefore suggests that parties should, if they so elect, be able to exclude extrinsic evidence as to the meaning of the contract (and thus force a court to have regard only to the terms of the contract itself) by use of a so-called “entire agreement” clause, though views were sought on whether such a clause should be enforced only where it has been individually negotiated.⁴⁴ If such a provision is to be included in any law reform, then it would seem sensible to suggest in that legislation a clear form of words which might be used for such a clause, in order to avoid interpretative uncertainty about the meaning and effect of such a clause itself. Moreover, if such a provision were to be given effect to, then it would seem imperative to provide that a court should interpret the relevant clause in a wholly objective fashion, without regard to any intention of the parties that cannot be gleaned from the text of the document itself.

The Commission sought views on matters other than the seven listed above, including on the potential costs of the proposed changes (one commonly held concern has been that the wider factual matrix of the type suggested by Lord Hoffmann would lead to more expensive litigation) and whether or not any reform should consider not just interpretation but also the law relating to statutory rectification of contract and personal bar, both of which have connections to the question of interpretation. Consideration of, at least, the rules on rectification may be sensible if a more subjective, “wide matrix” approach is to be taken to interpretation: some judicial defences of such an approach in recent case law give the impression that the new approach to interpretation is beginning to tread heavily on the toes of rectification,⁴⁵ leading to confusion as to which route should be adopted by the courts in any specific case.

⁴³ Paras 7.19-7.23.

⁴⁴ Paras 7.28-7.29. The ability to exclude such evidence would be consistent with the approach taken in a recent decision of the (English) Court of Appeal that parties may, in an entire agreement clause, exclude the implication by a court of a contract term on the basis of business efficacy: see *Axa Sun Life Services plc v Campbell Martin Ltd* [2011] EWCA Civ 133.

⁴⁵ See, for instance, Lord Reed’s defence of the Hoffmann approach in *Credential Bath Street Ltd. v Venture Investment Placement Ltd* [2007] CSOH 208 at para 19 ff, in which his Lordship argues that it is entirely proper for interpretation to “correct mistakes” in documents. If such a view – that interpretation can quite properly correct errors in expression – is correct, then it seems to pull the carpet from under the feet of the statutory

One issue mentioned at several points in the Discussion Paper, but which does not form the subject of any specific question or recommendation, is the idea that courts may, or should, take a “commercially sensible approach” to construing contracts. That they should so is an oft quoted mantra of the Scottish approach to interpretation.⁴⁶ Despite its judicial popularity, this idea is not without its problems. Judges may adopt a different view of commercial sense to that taken by the parties themselves, a danger which has been judicially remarked upon.⁴⁷ Moreover, the idea of commercial sense appears to have been pled in aid both of a natural/ordinary approach to interpretation as well as a more subjective, party orientated approach, giving rise to the suspicion that the idea of commercial sense is merely being used to justify the decision which a court wishes to reach.⁴⁸

More fundamentally, it may be asked why, if a party has been feckless in allowing a clause susceptible of a commercially disadvantageous sense to form part of the contract, it should be protected from the ill effects of this through a court giving the clause a commercially sensible interpretation rather than allowing that party simply to suffer the results of its commercial fecklessness. While, if both parties to a contract have acted in a commercially sensible way, it may not distort the contractual interpretation process to adopt a commercially sensible approach, if one of them has acted in a less than sensible commercial fashion, the superimposition of a commercially sensible approach to interpretation may result in providing that party with unwarranted assistance. A good demonstration of such unwarranted assistance may be seen in the decision of both Outer and Inner Houses in *Aberdeen City Council v Stuart Milne Group*,⁴⁹ where the view was taken that a sum of money to be paid by a buyer of heritable property to the seller in the event of an onward sale should be calculated by reference to the “open market price” of the onward sale rather than

remedy of rectification. His Lordship seeks to explain (at para 22 of his judgment) how, when interpretation is used to add words to a contract, this is distinct from rectification, but his explanation is not entirely convincing.

⁴⁶ The Discussion Paper states: “on the whole the Scottish courts have confined themselves to what is usually called a commercial or purposive approach to interpretation, seeking to give effect to the actual words used in the light of the circumstances surrounding the parties at the time they entered their contract” (para 5.1). Lord Drummond Young recently commented that “[i]n recent years the importance of construing contractual provisions in context, and in such a way as to give effect to the parties' commercial objectives, has been emphasized in a large number of cases; the principal authorities are well known and scarcely require discussion”: *Aberdeen City Council v Stewart Milne Group Ltd* [2010] CSIH 81 at para 11.

⁴⁷ See the comments of Lord Reed in *Credential Bath Street Ltd v Venture Investment Placement Ltd* [2007] CSOH 208 at para 24 that a judge should guard “against excessive confidence that [his] view as to what might be commercially sensible necessarily coincides with the views of those actually involved in commercial contracts”.

⁴⁸ One may note, in this respect, the cautionary words of Lord Hoffmann in the *Chartbrook* case at para 15: “It is, I am afraid, not unusual that an interpretation which does not strike one person as sufficiently irrational to justify a conclusion that there has been a linguistic mistake will seem commercially absurd to another.”

⁴⁹ [2009] CSOH 80; [2010] CSIH 81. The case has been appealed to the Supreme Court, where it is hoped that the Council’s position will be rejected.

just the “gross sale proceeds” (as the express wording of the contract stipulated). The Inner House stressed that to calculate the sum by reference to an inter-company sale, at well below market price, did “not make commercial sense”.⁵⁰

That may well be so. But why should commercial good sense be attributed to a party which has not shown it in the drafting to which it has consented? If Aberdeen City Council had wanted to ensure that the open market price was used to calculate its profit share, it could have provided for this in the contract, but it did not. Both Outer and Inner House judgments have effectively altered the contract agreed by the parties to give the Council a better deal than the one they negotiated. Such an approach goes well beyond interpreting a contract; it rather makes a new contract for the parties.⁵¹ All of these considerations suggest that use of the idea of the “commercially sensible approach” in a meaningful and helpful way in any development of the law must be viewed with a great deal of caution, despite its frequent appearance in judgments. This may well explain why the Discussion Paper has not built the idea in to any of its proposals or suggestions for law reform. Going further, there may well be sense in specifically excluding judicial use of the idea in the interpretative process, given its tendency to encourage judges to stray into contract making rather than contract interpretation.

D. THE WAY FORWARD FOR LAW REFORM

The Law Commission suggests that something must be done about interpretation (doing nothing is said not to be an option), and that what must be done ought, given the developments of the last fifteen years, to go beyond what was originally proposed in the RIPL.⁵² This suggestion is well made. There is currently such a diversity of opinion among the Scottish (and English) bench on the subject of interpretation that an agreed approach is unlikely to emerge through the developing case law. Some may worry that the creation of a distinctively Scottish approach, different to that adopted in the English courts, may create confusion and lead contracting parties to abandon Scottish law as the *lex contractus* in favour of its southern cousin. While joint English and Scottish Commission action on the matter might have been preferable (indeed, ideally the drafting of a complete Civil Code would be preferable to piecemeal development of the law), there is no doubt that a distinctively

⁵⁰ [2010] CSIH 81 at para 10 per Lord Drummond Young.

⁵¹ If the document signed by the parties was though genuinely not to reflect their underlying agreement, then rectification of the document should have been sought.

⁵² Discussion Paper on *Interpretation of Contract* (n 2) paras 7.1-7.3.

Scottish approach in other areas of contract law is a positive thing: no one, for instance, suggests that we should be concerned at the lack of a requirement of consideration in Scots law. One might also suggest that the certainty which a clear statutory approach would offer would be preferable to the current shifting position, where the outcome to litigation can often depend upon whether the judge determining the case favours a pro- or anti-Hoffmann approach. Such uncertainty of outcome cannot be good for contracting parties.

While many of the proposals in the Discussion Paper discussed above have merit to them, it has been suggested that the fundamental tension between objective and subjective approaches to the words parties use in their contracts cannot be dodged in the tentative compromise suggested by the Commission concerning the core or fundamental rule of interpretation; preference must be given to one over the other, the correct response to related practical issues emerging as a consequence of this choice. Some may argue that, as a prelude to possible European harmonisation of contract law, Scotland should fall in to line with the DCFR rule that preference is to be given to the common intention of the parties (considered in a wide factual context) rather than the objective meaning of the words used by them (considered in a narrower context). However, not only is the final position that may be adopted in any possible harmonised European law far from certain, but it has been suggested that a preference for the common intention of parties raises the spectre, in difficult cases, of leading courts back to an impractical emphasis upon subjective party intentions. It would be consistent with the historic trend of Scots law away from a naïve focus on subjective intention towards objective assessment of parties' conduct (save in exceptional cases⁵³) for a primarily objective approach to be taken towards the interpretation of contracts. Such an approach recognises the public as well as private aspect of contracts, is consistent with the use of the shared medium which is human language, and would minimise the temptation which some courts have unfortunately shown to seek to improve upon the bargains reached by the parties in the name of commercial good sense.

⁵³ Subjective intention is, for instance, looked at in cases where an error in transaction is pled by a contracting party.